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Foreign Direct Investment: Background and Issues

Both inward and outward foreign direct investment (FDI) are significant to the U.S. economy, international trade, and global supply chains, and form a key component of U.S. trade policy. Traditionally, the United States has supported a rules-based and open investment environment domestically and internationally to promote U.S. economic growth and other policy objectives, such as ensuring that the United States remains a premier destination for FDI and ensuring the competitiveness of U.S companies overseas. U.S. investment policy includes negotiating rules and market access commitments concerning FDI in free trade agreements (FTAs) and bilateral investment treaties (BITs), and administering investment promotion programs. At the same time, the United States maintains a foreign investment review regime to review a small share of inbound transactions that may pose a risk to U.S. national security; many other countries have such policies in place.

What is Foreign Direct Investment (FDI)?

FDI occurs when a resident of one country obtains a lasting interest in, and a degree of influence over the management, of a business enterprise in another country (commonly defined as 10% or more of the voting securities or equivalent interest). FDI can take the form of the establishment of new operations ("greenfield investments"), the purchase of existing operations (mergers and acquisitions, M&As), or the addition of capital to existing operations. It is distinct from portfolio investment, i.e., ownership of stocks, bonds, or other financial assets.

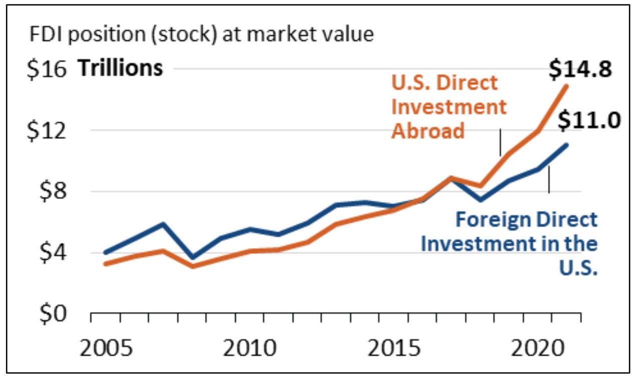
In June 2021, President Biden reflected these policy aims, reiterating the U.S. commitment to an open investment posture to "treat all investors fairly and equitably under the law" and "maintain a level playing field," while acknowledging that the government would review certain foreign investments to "protect national security." In recent years, Congress has enacted laws affecting U.S. investment policy, driven by a number of policy concerns, including the potential security and competiveness risks posed by China's investments in the United States and overseas. There is ongoing debate among various stakeholders about policies governing foreign investment and certain investor protections in U.S. trade agreements.

FDI Trends and Recent Investments

Globally, FDI flows rebounded in 2021, surpassing pre-Coronavirus Disease 2019 (COVID-19) pandemic levels. Recovery, however, was uneven; developed economies attracted more FDI than developing economies, and flows were concentrated in international project finance deals. Cross-border M&As were a big driver of U.S. FDI inflows.

The United States is the world's largest source and recipient of direct investment. In 2021, U.S. direct investment abroad (USDIA) stock stood at $14.8 trillion, while FDI stock in the United States totaled $11.0 trillion (**Figure 1**). From 2005 to 2020, USDIA more than doubled, while FDI into the United States nearly quadrupled (not adjusting for inflation). U.S. multinational firms (combined U.S. parent companies and foreign affiliates), in 2019, accounted for 67% of global employment, 75% of worldwide value-added, 78% of capital expenditures, and 86% of research and development.

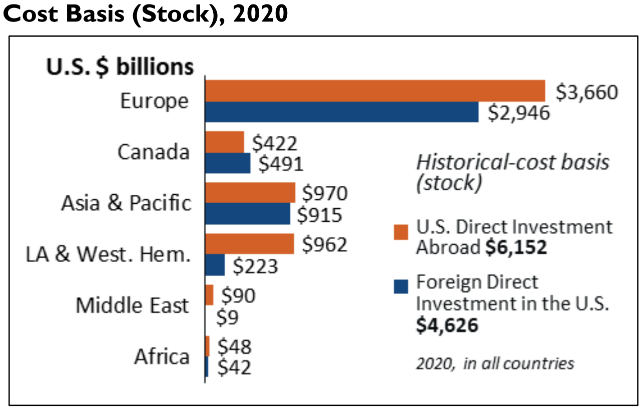
Figure 1. U.S. Direct Investment Position: Market Value (Stock), 2005-2021



Source: Department of Commerce, Bureau of Economic Analysis.

On a historical-cost basis, 75% of USDIA (stock) was in high-income countries. By region, Europe is the top U.S. investment partner, accounting for 59% of U.S. outbound investment and 64% of U.S. inbound FDI (**Figure 2**). By sector, in 2020, USDIA was mainly in holding companies (47%); manufacturing (16%), particularly chemicals; and financial services (14%). The largest share of U.S. inbound FDI (40%) was in manufacturing, again mainly chemicals.

Figure 2. U.S. Direct Investment Position: Historical-Cost Basis (Stock), 2020



Source: Department of Commerce, Bureau of Economic Analysis.

Key Debates and Issues for Congress

At the intersection of many competing interests, U.S. investment policy has been the subject of longstanding debate. According to some policymakers, foreign investment allows U.S. firms to expand in global markets, and attracts capital and businesses to the United States that support jobs. Others also assert that FDI can advance U.S. foreign policy and other strategic objectives. At the same time, there are policymakers who argue that U.S. outbound investment may offshore U.S. production and jobs. Some also contend that certain outbound investment and related technology transfer may not be market-driven and may undermine U.S. competiveness. There are also concerns that Chinese investment challenges U.S. economic and national security interests. Congress could examine several aspects of U.S. FDI policy, including the effects of FDI on the U.S. economy, firms, workers, and U.S. supply chains; further reforms to foreign investment reviews and whether to require greater transparency and oversight of U.S outbound investment; U.S. investment policy objectives and commitments in FTAs and BITs, and new initiatives; trading partner FDI policies and trade barriers; and the effectiveness of investment promotion programs.

Foreign Investment and Outsourcing. Some observers are concerned that U.S. investment abroad contributes to slow growth in jobs and wages in the United States as firms are seen as outsourcing jobs, particularly in manufacturing, to lower wage countries. There are examples of U.S. firms closing a U.S. plant and opening one abroad, but there are no official sources that track such activities. Most USDIA, however, is in developed economies that are similar to the United States, and most production by foreign affiliates is consumed where it is produced and is part of a strategy to access markets abroad. Foreign affiliates on average sell most of their output in the country in which they are located or to neighboring countries; about 10% of foreign affiliate sales is to their U.S. parent companies. Economists generally attribute the decline of manufacturing jobs to broader factors, including economic recessions and improvements in productivity (e.g., technology) that have allowed the sector to produce more with fewer workers.

Foreign Investment and National Security. There is growing concern among some that certain foreign investments by firms that are directed, controlled, or funded by a foreign government, may raise national security concerns. Such risks are reviewed by the Committee on Foreign Investment in the United States (CFIUS), an interagency committee that serves the President, who has authority to block or suspend transactions that threaten to impair U.S. national security. In 2018, Congress updated laws governing CFIUS reviews with the Foreign Investment Risk Review Modernization Act (FIRRMA, P.L. 115-232), as well as export controls. See CRS In Focus IF10177.

Some policymakers argue that the rise of Chinese state-directed investments requires a more proactive and strategic approach that considers foreign investments in aggregate terms, instead of on a case-by-case basis. FIRRMA expanded CFIUS's jurisdiction to review transactions, including non-controlling investments and acquisitions that involve critical technologies, critical infrastructure, and sensitive personal data, and some real estate transactions. Some are concerned that even with recent reforms certain transactions, particularly in greenfield, emerging technologies, and private equity, may evade or fall outside current U.S. authorities and review. Revisiting past debates, some pending bills would create a new committee to review certain U.S. outbound investment involving "national critical capabilities" in "countries of concern."

U.S. International Investment Agreements. As World Trade Organization (WTO) agreements address investment in a limited manner, BITs and FTAs provide the primary tools for establishing investment rules globally. The United States is party to BITs or FTAs with investment chapters with over 50 countries. These agreements aim to reduce FDI restrictions and ensure nondiscriminatory treatment of investors and investment, subject to national security and other exceptions, balancing other policy interests—typically enforced through binding arbitration under investor-state dispute settlement (ISDS). BITs require two-thirds Senate approval; FTAs require approval by both Chambers to enter into force. The U.S.-Mexico-Canada Agreement (USMCA) contains the most recent set of U.S. investor protections. It varies in key respects from other U.S. FTAs, notably limiting recourse to ISDS. See CRS In Focus IF10052.

Congress set U.S. investment policy negotiating objectives most recently in the 2015 Trade Promotion Authority (TPA) (P.L. 114-26), which expired in July 2021. Congress may seek to set new objectives as part of potential consideration of TPA renewal, or separately. It also may consider investor protections in potential future FTA or BIT talks, as well as examine the possible need for multilateral investment rules, such as in the WTO. Additionally, Congress may monitor investment components of new U.S. initiatives, such as the U.S.-EU Trade and Technology Council (TTC), which aims to promote cooperation on investment screening, and the proposed Indo-Pacific Economic Framework (IPEF), which aims to promote infrastructure and clean energy investment.

Investment Promotion Programs. The U.S. government maintains programs both to facilitate U.S. outbound and inbound FDI. The U.S. International Development Finance Corporation (DFC) aims to promote private investment in less-developed countries. DFC's establishment in the BUILD Act of 2018 (P.L. 115-254) was part of the U.S. policy response to China's "One Belt, One Road" initiative. DFC provides financing, political risk insurance, equity, and technical assistance for investment projects. In contrast, SelectUSA, a Department of Commerce program established by a 2011 executive order, aims to coordinate federal efforts to attract and retain foreign investment, on top of state-level efforts. It provides information on investment, and aims to help resolve issues involving federal programs and activities and to advocate for FDI.

Congress may examine DFC's effectiveness in supporting U.S. commercial and policy interests to expand overseas and compete with China. It also may examine whether potential codification of SelectUSA would affirm U.S. interest in competing for FDI or raise overlap concerns due to existing sub-federal investment attraction programs. Other issues include DFC and SelectUSA's roles in facilitating FDI to support critical U.S. supply chains.

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